Profit Meets Purpose: Turning Challenges into Opportunities

One-off Ideation Workshop

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Preparation

To prepare for the upcoming client meeting with STITCH, the H|F team must have an understanding of the company's foundation and value chain. STITCH is a purpose-driven company which means that how we tailor recommendations, frameworks, and processes must align with their core values and governance. It is vital that the qualitative outcomes and key results align to support STITCH's objectives. The team will familiarize themselves with important reports and documents such as the CPD, SAS, TCFD, ESG progress reports, and the 10-K. Based on initial research, the consulting team can provide STITCH with the tools they need to reach the next milestone and ensure progress on their goals. In order to curate a holistic process and tools for STITCH's sustainable business strategy, the H|F consulting team will identify situational factors and challenges particular to STITCH as well.

It is vital that the team also have insight into what the current processes and structures look like at STITCH. We need to be able to give STITCH employees more than just arbitrary solutions, but innovative methods that can actually work to create viable outcomes. This is not only a strategy workshop but a chance to build a relationship with the client for future endeavors.

At H|F Consulting, we understand that a single workshop is not going to be responsible for changing the culture and attitudes within the workplace. However, we believe that strategic sustainability workshops are vital to planting the seed that later blossom into a company-wide paradigm for sustainability.

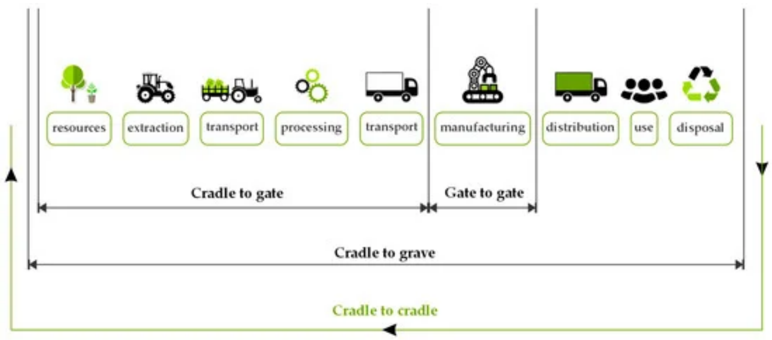
Situational Factors

Value Chain Complexity

The apparel industry operates in a notoriously complex value chain with many key players that must adhere to a variety of standards and regulations.

For a company working within the apparel industry, there are already various challenges in the supply chain alone. When it comes to understanding where a company stands to make progress in their sustainability, it is vital to consider the full extent of the value chain because this can inform supply chain strategy. There is a wide range of suppliers, resource locations, and other players, so most companies try to focus on bringing their tier 1 suppliers on board to the company's sustainability goals first. They are the easiest to leverage, especially if the company is a keynote contract holder.

Companies understand that their supply chains can be volatile and minimizing any risk is crucial to running the business smoothly and efficiently. When a company has a good handle on their supply chain and can guarantee quality, consistent results, they are more likely to recover from any supply shocks that would normally be a critical hit.



Definitions:

- ➔ <u>Supply chain:</u> Firms upstream from focal-point firm.
- ➔ <u>Life cycle</u>: Movement of product or service through production, consumption, and disposal/reuse.
- ➔ <u>Value chain</u>: All actors, activities, and impacts in the production and consumption of a product, situated within broader economic, environmental, and social systems.

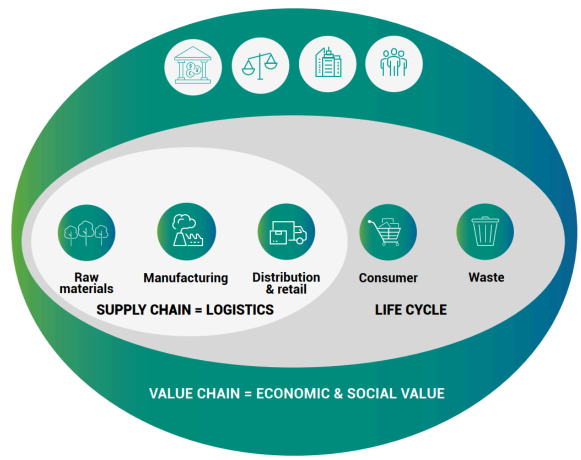


Fig. 1: Cradle to Grave, Fig. 2, Value Chain

Regulation and Reporting

Within the apparel industry, reporting and regulation focuses on the environment, trade, and labor practices. It varies based on geographic location, so it is crucial for multinational companies to adapt their practices to local standards when operating in different regions.

In addition to existing regulations, there are expectations that more restrictions are going to be set as countries become more serious about environmental and social issues.

Within the U.S. for example, there are different protocols taken by different agencies to ensure that companies are not importing or exporting goods made with exploited labor. Such regulation is going to crack down harder in upcoming years as governments and organizations try to stop the use of exploited labor and products that may have involved toxic chemicals in the manufacturing process.

As regulation increases, mandatory reporting will also go into effect for several impact areas. Companies will be urged to report their carbon emissions (scope 1, 2, 3), water and energy usage, waste disposal, and other related metrics. Many companies have already been producing Environmental, Social, and Governance Reports. To avoid unnecessary fines, companies will have to stay on top of their reporting. This also allows companies to have accurate metrics to track their progress. The Securities and Exchange Commission (SEC) has expanded its climate-related disclosures in SEC filings. This will require companies to adhere to SEC Climate Disclosure Rules, which include financial reports, governance, targets and goals, and other details.

Market Expectations and Trends

Seasonal trends mean companies have to be efficient in their process of ideation, production, and distribution.

In the era of social media and online shopping, trends are changing rapidly and with online shopping, companies can put their products up for sale even quicker. Technology is revolutionizing the apparel industry and making the cradle to gate process a more efficient system. Although tech is able to keep pace with production, there are bottlenecks occurring in the creation of new products.

The apparel industry is consumer cyclical and sells discretionary goods, so people need to be convinced that these clothes are something that they absolutely need. Rapidly changing trends also incentivize businesses to mass produce certain items, and in many cases there is overproduction that later contributes to landfill waste.

Furthermore, bottlenecks are occurring in the developmental stages because companies are running into the problem of balancing “What will be the next hit?” and “What will be the demand?”. Apparel companies are trying to keep up with the volume and variety of trends coming out of social media platforms, while also trying to appease multiple stakeholders.

In addition to the new style trends, more consumers are becoming concerned about the environmental and social impacts of their clothing. So apparel companies are put in the unique position of creating products and services that appeal to an individual’s personal style, while upholding values that promote brand image. While this concept may pose challenges, the apparel industry is oriented to investigate new opportunities and innovations before other industries. Companies that specialize in fashion and textiles can create and set examples for other industries that are looking to incorporate sustainability into their design and operations.

Client Challenges

Ethical Sourcing of Materials and Labor

Some may see the challenge here as adhering to government regulation, however, it takes another step to go above and beyond in environmental and social responsibility. That's where the real challenge is. In the apparel industry there is more concern about where and how materials are sourced because there are so many individual inputs required to manufacture clothes, shoes, or accessories. It has proved difficult to be 100% transparent in the supply chain.

Most companies do not have widespread control over the actions of their tier 2 and 3 suppliers, so it is more difficult to ensure ethical sourcing. Companies typically have more leverage on their tier 1 suppliers/factories that produce the majority of the company's supply.

Most companies try to avoid the use of unethical practices by using audit services or operating with manufacturers that have high reputations. If a company is found to have made products with materials that required exploitative practices, it is detrimental to the brand image and the value to stakeholders. Businesses have entered an era where shareholders are not the only stakeholder considered, if exploitative practices are revealed it also means a drop in sales and potentially employee retention rates.

Although the ethical sourcing of materials and labor is a challenge that companies must overcome, it provides an opportunity to set an example for other companies that want to become more socially and environmentally responsible. Depending on what tier a supplier is, a company has the opportunity to work with the supplier to create a stronger code of conduct that is more evolved to represent the governance and values of the brand.

Water and Chemical Use

Water and chemical use pose significant challenges for businesses in the apparel industry, both environmentally and socially. The production of textiles, especially processes like dyeing and finishing, requires vast amounts of water and often relies on hazardous chemicals. This excessive water use strains local water supplies in manufacturing regions, many of which already face water scarcity. Additionally, improper wastewater management leads to pollution of rivers and ecosystems, threatening biodiversity and the health of surrounding communities.

It is vital that companies are taking care of the community and their workers, but they must also ensure the viability of the environment in which they operate. The company may lose the right to operate in an area if their factories are creating health hazards for local populations and ecosystems. This concern is heavy within the apparel industry where it is common to use chemicals and synthetics in textile production.

Several steps within the value chain require the use of water or chemicals to manufacture and distribute products. With a water crisis occurring in several countries it is likely that it will become more expensive to use certain resources, and in some cases those resources may no longer be available altogether. Companies within the apparel industry must prepare to face a world where they have to pivot and make changes to their supply chains because of climate change. Companies have already begun to implement water use reduction programs because it is beneficial to solve this problem before it becomes catastrophic.

Waste Management

Waste management is a critical challenge for businesses in the apparel industry, with significant environmental and social implications. Fast fashion and mass production contribute to enormous amounts of textile waste, much of which ends up in landfills or is incinerated, releasing greenhouse gases and toxic substances into the environment. Additionally, production waste, such as fabric scraps and defective items, further exacerbates the issue.

Poor waste management practices can impact communities near production and disposal sites, exposing them to pollution and health risks. Moreover, stakeholders and consumers increasingly demand transparency and accountability in how businesses handle waste, pushing companies to adopt sustainable solutions.

Effective waste management strategies, such as recycling, upcycling, and embracing circular economy principles, can mitigate these impacts. By designing for durability, promoting garment reuse, and innovating with biodegradable materials, apparel companies can reduce their environmental footprint while aligning with their social responsibility goals. Prioritizing sustainable waste management is essential for long-term business viability and maintaining consumer trust in an environmentally conscious market.

Greenwashing Risks

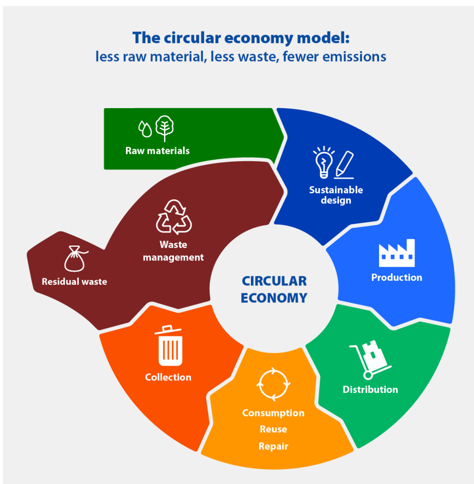
Greenwashing presents a significant challenge for businesses aiming to incorporate more sustainable strategies, as it undermines both their credibility and genuine environmental efforts. Greenwashing occurs when companies exaggerate or misrepresent their sustainability practices, creating a perception of environmental and social responsibility without substantial action. While this may provide short-term marketing benefits, it often leads to consumer skepticism and loss of trust when claims are exposed as misleading.

For businesses committed to genuine sustainability, greenwashing in the industry creates a difficult challenge. It can dilute the impact of authentic initiatives by making it harder for consumers to differentiate between truly sustainable practices and superficial claims. This not only affects consumer confidence but also increases regulatory scrutiny, as governments and watchdog organizations introduce stricter guidelines to combat misleading environmental claims.

To overcome this challenge, businesses must prioritize transparency, align actions with credible third-party certifications, and communicate measurable sustainability outcomes. By avoiding greenwashing and focusing on authentic change, companies can build trust, enhance brand reputation, and position themselves as leaders in sustainable business.

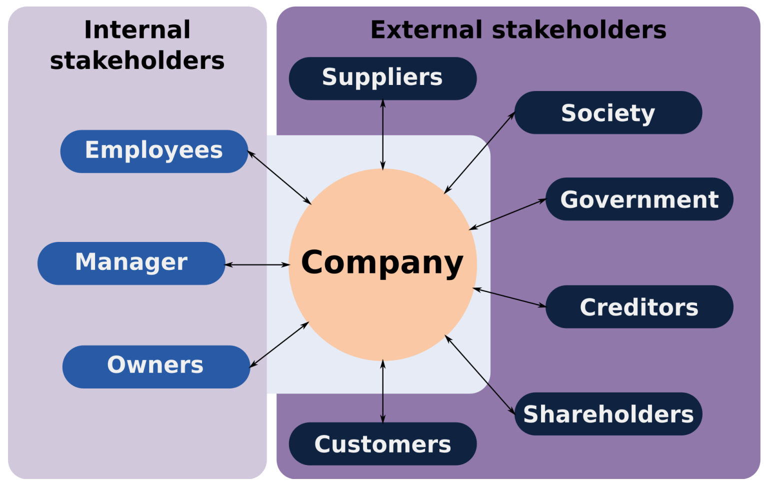
Transition to Circularity

Transitioning to a circular business model presents several challenges for companies in the apparel and textile industry, as it requires fundamental changes to traditional production, distribution, and consumption practices. A circular model focuses on designing out waste, extending the lifecycle of products, and maximizing resource efficiency through recycling and reuse. While circularity offers environmental and economic benefits, its implementation is complex.



A major challenge is the redesign of supply chains to accommodate closed-loop systems, which may require significant investment in new technologies and infrastructure. Collecting, sorting, and recycling used garments at scale is labor-intensive and costly, especially in regions lacking advanced recycling facilities. Additionally, creating durable, recyclable textiles often demands innovation in materials, which can increase production costs. For instance, many companies make high quality clothing using a blend of fabrics, but downstream the value chain, these products are incredibly hard to dispose of in a way that is sustainable and can be reused.

Social and consumer behaviors also play a role. Encouraging customers to participate in take-back programs or adopt second-hand and repaired clothing can be difficult in a fast-fashion culture that prioritizes low-cost items. Aligning stakeholders across the value chain and ensuring transparency about circular practices are significant hurdles. Despite these challenges, a successful transition can enhance brand reputation, reduce environmental impact, and position companies as pioneers in sustainable fashion, fostering long-term resilience in a resource-constrained world.



Sustainability Workshop Synopsis

"Profit Meets Purpose: Turning Challenges into Opportunities"

The H|F Consulting team is prepared to lead STITCH employees through a workshop that focuses on building sustainability strategy without "starting from scratch". As the saying goes, "Don't throw the baby out with the bath water". During the workshop we will take you through the steps to identify challenges, especially those related to sustainability strategy, and what solutions have proved to be successful.

Our goal is to inspire new habits while promoting the idea that sustainability does not mean that employees have to sacrifice the goals and mission of the company. This new age of “sustainable business” appears at first to be daunting and require an overhaul of the system, but in reality we have always practiced sustainable business. Sustainability refers to the idea that a practice is able to be upheld or continued. There has been some form of risk, and people have strived to minimize that risk, keeping the end goal in mind, which is to keep the business running. And nowadays the threats may look different, but they are just as impactful. But, when backed into a corner, innovation is spurred. We can turn these challenges into opportunities that allow the company to thrive in a time where we are seeing unprecedented changes to the resources we heavily rely on.

Workshop Strategy

Strengthen Brand Image

One of the key benefits to implementing sustainable business strategies is the response from consumers. The overall reputation of a company impacts customer loyalty, trust with stakeholders, and provides a competitive advantage against rivals. How the company actually operates then forms how the employees view the company, and contributes to the level of quality delivered by employees. The way the company operates and how they are seen is incredibly influential to how they're received by customers. This drives how people make choices about the products they are choosing. A study released by PWC in May of 2024 reveals that consumers are continuously willing to pay a “sustainable premium” on products even as the cost of living increases. The study also reflects on how 85% of respondents noted they had felt some impact from climate change. As more and more populations are being affected by drastic weather, scarcity, and global inflation, people are willing to pay more for a product that will not negatively affect themselves and their communities.
Transparency as a sustainable business strategy provides:

1. Strengthened brand loyalty
2. Increases up sales
3. Builds trust amongst stakeholders

Cost Savings

The most eye-catching case for sustainable business is the financial benefits. Which not only include increased sales, but the ability to become more efficient in spending.

Although these benefits are only a few ways that sustainable business encourages cost reductions, many of the options that companies can choose from simply involve saving money by eliminating inefficiencies.

Whether this process is done through technological advancements or worker engagement. When you can pinpoint target areas that need efficiency improvements, you are better equipped to create a solution that works with stakeholders and reduce overall costs.

Cost savings can come in the form of:

1. Reduced energy costs
2. Waste Reduction (spending less on disposal)
3. Logistics Optimization (spending less on fuel and idle time)

Mitigate Risks to Value Chain

It pays to be socially, environmentally, and economically responsible. If you don't take into consideration these factors, large portions of the value chain could be at risk. When there's more risk, there's usually a lot of money involved.

Sustainable business is incredibly important to mitigating risks throughout the value chain. Businesses have to consider if they will have access to the same resources decades from now. If there are supply shocks in one industry, that could have a ripple effect onto other industries. Value chains are heavily connected and dependent on each other. If a keystone part of the supply chain no longer exists, how will that affect the rest of the company's ability to operate. The benefits that sustainable business strategy provides to the stability of the value chain are innumerable.

For instance, if there is a workers strike due to working conditions, or a tsunami that takes out a tier 1 supplier, these could prove to be intense challenges. To avoid complications such as these, a sustainability strategy would help to provide insight on mitigating risks.

However, a few notable benefits include:

1. Decrease Employee Turnover
2. Advance Capital Asset Risk Management
3. Relieves critical resource dependencies

Promote Innovation and Business Value

A sustainable business strategy drives innovation by encouraging companies to leverage advanced technologies and explore groundbreaking opportunities. Integrating sustainability often leads to the development of cutting-edge solutions, such as renewable energy systems, AI-driven resource optimization, and circular business models. These advancements not only open new market opportunities but also redefine industry standards, giving businesses a competitive edge. Furthermore, sustainable innovation fosters resilience by addressing future challenges, such as resource scarcity and regulatory shifts.

By embracing sustainability, companies unlock:

1. long-term business value
2. Positioning companies as leaders in a rapidly transforming global economy
3. Enhanced competitive advantage

Resources for developing the Workshop

Figure 1, Cradle to Grave,
https://www.mdpi.com/2071-1050/16/14/6094#B12-sustainability-16-06094
This article was originally intended to provide a life-cycle assessment for professional footwear, however it includes a brief overview of the cradle to grave model. They outline the steps and how they are interconnected. This article is helpful in visualizing and connecting the different parts of the value chain together.

Figure 2, Value Chain,
https://www.unep.org/resources/publication/catalysing-science-based-policy-action-sustainable-consumption-and-production
This article talks about the "Value Chain Approach" to looking at business challenges. The author looked into several large sectors including textiles, to see what the value chain approach looks like in application. The author outlines how beneficial looking at the whole value chain can be. It allows companies to identify areas that could be at risk or improved.

What US Companies need to know about the EU's CSRD,
PwC's article, "What US companies need to know about CSRD," provides a comprehensive overview of the European Union's Corporate Sustainability Reporting Directive (CSRD) and its implications for U.S. businesses. The directive mandates enhanced sustainability reporting, aiming to increase transparency and accountability in corporate environmental and social governance. PwC outlines key requirements, timelines, and the potential impact on U.S. companies operating within the EU or with significant EU market interactions. The article serves as a valuable resource for understanding compliance obligations and strategic considerations related to CSRD.

Navigating the SEC climate-related disclosure requirements
PwC's article, "Navigating the SEC climate-related disclosure requirements," offers an in-depth analysis of the SEC's climate disclosure rules adopted on March 6, 2024. The publication details the expanded requirements for climate-related disclosures in SEC filings, covering areas such as strategy, governance, risk management, targets, greenhouse gas emissions, and financial statement impacts. It also outlines phased effective dates and transition provisions, providing guidance for companies to comply with the new regulations. This resource is essential for understanding the implications of the SEC's climate disclosure rules and preparing for compliance

A Landmark Decision for climate disclosure requirements

Deloitte's article, "Heads Up — Executive Summary of the SEC's Landmark Climate Disclosure Rule," outlines the significant components of the SEC's final rule on climate-related disclosures, issued in March 2024. It highlights changes such as the elimination of Scope 3 GHG emission disclosures and the extended adoption timeline. The publication also details required disclosures, including Scope 1 and Scope 2 emissions, governance, risk management, and material climate targets. This resource is invaluable for companies preparing to align with the SEC's enhanced transparency and compliance standards, offering a comprehensive guide to navigating these transformative regulatory changes.

Climate-Related Disclosures For Investors, SEC Adopts Final Rules, March 13, 2024

This short Youtube video, which is provided by the SEC, gives an explanation of what to expect in the new SEC required filings. The video outlines what information and data will be required, and when these requirements will begin.

PWC report on Sustainable Premiums on Products, May 2024

PwC's 2024 Voice of the Consumer Survey reveals that consumers are willing to pay an average premium of 9.7% for sustainably produced or sourced goods, despite concerns over inflation and cost-of-living increases. The survey, encompassing over 20,000 consumers across 31 countries, indicates that 85% have personally experienced the effects of climate change, influencing their purchasing decisions towards sustainability. However, 31% identify inflation as the primary risk to their consumption habits, with 62% anticipating significant increases in grocery expenditures. This report underscores the complex balance consumers maintain between economic pressures and environmental considerations.

Best Practice Guides, B Corp,
https://kb.bimpactassessment.net/support/solutions/43000035002

B Corp offers several "Best Practice Guides" to help companies navigate their journey to becoming businesses for good. B Corp wants all companies to have access to the resources and materials they need to become more environmentally and socially responsible.